

This letter discusses the taxation of excess mileage, wear & tear, cancellation, and other administrative fees in leasing situations. See 86 Ill. Adm. Code 130.220. (This is a GIL).

July 12, 1999

Dear Mr. Xxxxx:

This letter is in response to your letter dated May 18, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

This is a request for an official opinion or ruling from your Department on whether or not sales tax should be charged on certain fees collected or charged by our client in your state. The services provided by our client and related fees are described below.

FACTS

Our client will begin operations in your state in the fall of this year to provide certain services to vehicle leasing companies and their customers in the form of an agency relationship with the leasing companies. Our client will provide a facility in your state to which the lessee turns in their vehicle at the end of a term lease. The client inspects each vehicle for application of the fees as outlined below. On behalf of the lessor, our client will collect the appropriate fees from the lessee in accordance with the lease agreement. The client will safeguard the vehicle and then route the vehicle to the appropriate destination.

Our client collects the last lease payment from the lessee as well as the following fees as appropriate; the detail of which is included in writing in the original lease document.

- Disposition -- fee charged for lease termination processing.
- Excess mileage -- fee charged for mileage over allowable limits as stated in the lease agreement.
- Excess wear & tear -- fee charged for abnormal wear.

Each fee collected from the lessee will be listed separately on the statement furnished the lessor.

July 12, 1999

Our client will receive the following fees:

- Transportation brokerage -- referral fee received from the transportation companies.
- Cancellation -- fee charged to lessor for cancellation of a lease termination assignment.
- Administration -- service fee charged to lessor for the inspection, safeguarding and routing of their vehicles.

REQUEST

Please advise us as to whether or not our client should collect sales tax on each of the fees collected from the lessee and the fees charged to the lessor or the transportation companies as outlined above. This ruling should be issued at whatever level and in whatever format is appropriate to be binding to the Department based upon the factual situation as presented above.

We appreciate your assistance in this tax matter. If you have any questions or need additional information, please contact me at ####.

FEES COLLECTED FROM LESSEES

Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax. Fees associated with conditional sales may be taxable, depending upon the specific nature of the fee or charge.

In contrast, a true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property.

The State of Illinois imposes no Retailers' Occupation Tax or Use Tax on rental receipts. Rental charges for a sublease are also not subject to such taxes in Illinois. Since a lessee incurs no Retailers' Occupation Tax or Use Tax

liability on the lease of an automobile for a lease period in excess of one year, the lessee incurs no such tax liability on any related lease charges such as fees for the disposition or termination of the lease, excess mileage fees, or fees for excess wear and tear.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq. See also the enclosed copies of 86 Ill. Adm. Code 180.101 and 190.101.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. Please note that Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

#### FEES CHARGED TO LESSORS OR TRANSPORTATION COMPANIES

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. Businesses that provides services, such as those listed in your letter, to leasing companies and transportation companies generally do not involve the transfer of tangible personal property to their customers.

However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See the enclosed copy of 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. The servicemen may calculate their tax base in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

July12, 1999

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Terry D. Charlton  
Associate Counsel

TDC:msk  
Enc.